Dynamic Quant

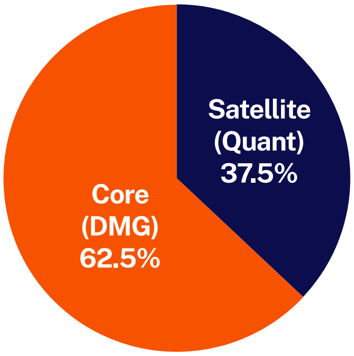
Congress Wealth Advisor Solutions

congresswealthadvisorsolutions.com

The Dynamic Quant Strategy

The Dynamic Quant strategy uses Congress' Dynamic Moderate Growth (DMG) portfolio as the core, and then adds on a purely quantitative ("Quant") satellite allocation. The DMG's actively managed core portfolio is 62.5% of the total portfolio, while the quantitative satellite allocation makes up 37.5%. This fixed allocation to the strategies within the portfolio allows investors to take advantage of the benefits offered by DMG and Quant, while mitigating the risks of both.

Dynamic Quant is a one-size-fits-all approach to investing. At 'neutral', the portfolio is benchmarked to a 75% equity and 25% fixed income benchmark. We believe this tilts the portfolio to a growth oriented mission and is suitable for investors who need capital appreciation as a basic objective of their portfolio. However, both the DMG and the quantitative satellite allocation of the portfolio are actively managed. DMG targets a 60% allocation to equity at neutral, but the managers of this portfolio have the discretion to reduce the equity allocation to as little as 30% when deemed appropriate. The 37.5% of the total portfolio allocated to the Dynamic Quant strategy can go 100% to cash. As a result, when Congress analysts are bearish and the quantitative method* dictates that the allocation goes to cash, the overall portfolio could have a total allocation to risk assets of less than20%of the total (or even less, depending on how bearish the DMG portfolio is positioned).



In bull markets the opposite is true. If the DMG core portfolio is bullishly positioned and the allocation is 50% above the 60% risk target at neutral, then the total portfolio, including the Quant satellite allocation, could be invested upwards of 90%in equities or other risk assets. The ability to rotate from as much as 90%equity to as little as 20% equity gives the Dynamic Quant strategy the unique ability to serve the needs of both growth investors in bull markets and conservative investors in bear markets.

What is Quant"?

Quant or "quantitative analysis" is a sophisticated method for making investment decisions. Where traditional investment decision making is based on the analytical skills and sound judgment of investors, a quantitative approach uses mathematical rules to make decisions about portfolio construction.

The benefit of this approach is that it's immune to the fear and greed that often influences the human participants in the financial markets. It is a scientific fact that humans are genetically programmed to make decisions emotionally. Behavioral psychologists tell us that humans are subject to many biases and heuristics (short cuts or rules of thumb) that can lead to systematic mistakes in making investment decisions.[1]

Quantitative decision-making takes the emotion out of investing. It substitutes the power of computer algorithms to sort through mountains of confusing and often conflicting data. As a result, those who use it are able to find investment opportunities that are often swept away by the 'madness of crowds' and the emotions of the moment.

[1]*Cognitive vs. Emotional Investing Bias: What's the Difference? By Tim Parket, Investopedia, March 18, 2021.*

How we manage risk

The freedom to reshape the asset allocation of a portfolio changes how risk is typically managed. The traditional method involves choosing a benchmark for the portfolio that has a well-defined allocation to risky assets — typically stocks, commodities, and real estate. By pre-setting the target, the manager can forecast portfolio returns and volatility based on the past performance of those risk markets. In theory, as long as the manager owns the target asset allocation, the client can use past results to plan for future returns. Recent history has shown the danger of this approach.

At Congress, we are not constrained to buy and hold a single asset allocation that is presumed to be efficient in all market conditions. Instead, we target a range of volatility for each of our portfolio models, allowing our analysts to select only those classes that offer our clients the best value. The volatility targets for portfolios are determined by the historical volatility of their specific benchmark portfolio. By changing the investment process to include the notion of evaluating the value characteristics of asset classes, we reduce the risk that our portfolios will be negatively affected by misbehaving markets.

Congress establishes the volatility target for the Dynamic Quant portfolio by back-testing its benchmark portfolios to establish a base range of volatility. For example, the volatility of our Dynamic Quant strategy is comparable to the volatility of a portfolio with 37.5% MSCI Daily TR Net USA USD index, 27.5% S&P Total Return Index, 7.5% MSCI Daily Total Return Net EAFE USD Index, 2.5% Commodity Blended Benchmark, 22.5% Barclays Capital US Aggregate Bond Index and 2.5% 0-3 Month US T-bill Index even if the Dynamic Quant strategy actually owns a different asset allocation than the benchmark.

At any point in time, depending on how we view the weight of the evidence (based on our research), we can increase or reduce volatility relative to our portfolio benchmarks. These changes allow us to reduce portfolio volatility in anticipation of bear markets, or increase volatility in anticipation of bull markets. In all cases, asset allocation changes are made incrementally. While our analysts are free to find the best value propositions anywhere in the world, they are not free to turn a conservative portfolio into an aggressive portfolio with high amounts of potential volatility.

Our safeguards

We believe the solution to the problems of buy and hold investing is active portfolio management. However, active management has its own unique set of concerns. We change our portfolio construction based on our research and analysis of what asset classes offer the best value, but we can never be sure in advance that our view is correct.

We sometimes make forecasting mistakes. That's why we designed our investment process to include a series of safeguards that prevent major errors.

» We make investment decisions as a team. Our strategy doesn't depend on a single superstar manager who might go on a cold streak and make a series of investment blunders.

» We use a weight-of-the-evidence approach to decision-making that requires a significant majority of factors in reaching investment conclusions. This helps defend against the possibility that dogmatically following any one factor will lead to an incorrect conclusion about the markets.

» We find investment value using five different methods, which defends against the possibility that any one method might give a false signal.

» We make decisions using both quantitative (rules-based mathematical models) and qualitative (judgment, experience and intuition) methods.

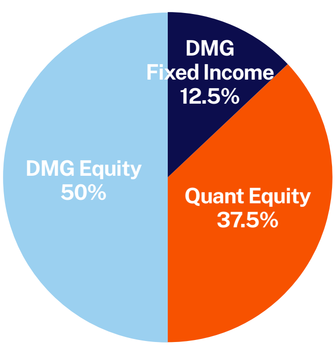
» We typically make only small, incremental changes to portfolio asset allocations, believing that sudden, major shifts put our clients' money at risk.

Under the hood

The Dynamic Quant strategy will always be invested such that 37.5%of the total portfolio is in a Quant satellite allocation. The Quant satellite allocation rotates between eleven U.S. equity sectors and fixed income, depending on how the quantitative model evaluates current market conditions.

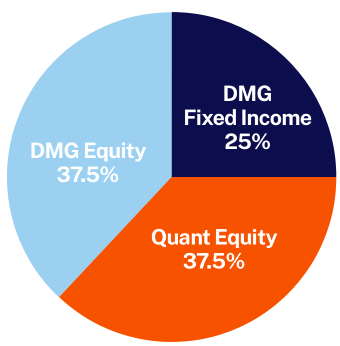
The quantitative rules are designed to evaluate U.S. equity sectors on two different metrics – valuation and momentum – where valuation is given a much higher weight than momentum in the overall decision. Equity sector weightings are tied to each sector's weight in the S&P 500 Index, where the allocation can be as high as Index + 15%, equal to the Index and as low as Index -15%. Since the model will not short a sector or actually own a negative sector weight, the result is that the Quant satellite allocation of the portfolio will typically own 4 to 8 of the best U.S. equity sectors at any one time.

During periods of market turbulence, the Quant satellite allocation has the ability to sell all U.S. equity sectors and move to either cash or bonds. The decision is made by our proprietary Technical Model, which is designed to assess the overall technical health of the market based on a wide range of technical indicators. The Technical Model is calibrated to keep the Quant satellite allocation invested in stocks the majority of the time and only sell stocks under the most adverse market scenarios. In this case, all sectors are sold and will be allocated to either U.S. bonds or cash, depending on the current market environment. The rules for going to cash create a binary decision where the Quant satellite allocation is either fully invested in U.S. equities or is fully invested in cash or bonds.



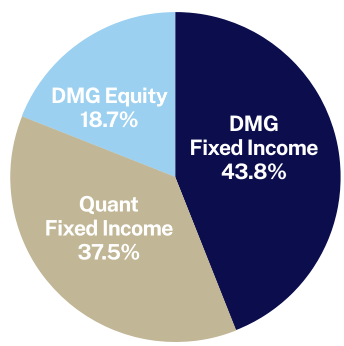
Aggressive Stance

This hypothetical illustration shows the **Dynamic Quant** portfolio when the strategy has an overweight to stocks and underweight to fixed income. Assuming that the core **Dynamic Moderate Growth (DMG)** portfolio has also been positioned aggressively, and assuming that Congress analysts position the portfolio equity exposure to 1.33% of benchmark, then the fixed income exposure would be reduced to 12.5%, and the equity exposure would be increased to 87.5% of the total portfolio.



Neutral Stance

At neutral market conditions, the **Dynamic Quant** portfolio is benchmarked to 75% equity and 25% fixed income. The portfolio allocation to the quantitative model is fixed at 37.5% of the portfolio and is 100% invested in U.S. equities (unless the model sells equities and buys cash or bonds). At neutral the core DMG portfolio is 60% equity and 40% fixed income. Combined with the Quant positions, the equity allocation is 75% of the total while the fixed income position makes up 25%.



Defensive Stance

This hypothetical illustration shows the **Dynamic Quant** portfolio when the Quant satellite allocation sells stocks and invests in cash or bonds. Assuming that the core DMG portfolio has also been positioned defensively, and assuming that Congress analysts position the equity exposure to 50% of benchmark, then the fixed income position would be 81.3%of the total portfolio and equity exposure would be reduced to only 18.7% of the portfolio.

The six building blocks of Congress' proprietary investment process

At Congress, we change the allocation of our portfolios based on our fundamental belief that asset classes will earn the best returns when we buy them at prices that represent good values. But what makes an asset a "good value"?

We use six different methods to determine valuation.

BUSINESS CYCLE

1. DETERMINING THE BUSINESS CYCLE

The economy and financial markets move in a never-ending pattern of economic expansion to economic contraction, and back again. When the economy is expanding, risk assets like stocks, commodities, and real estate tend to earn their best returns. On the other hand, when the economy is contracting, non risk assets like cash, bonds, and other strategies with low volatility tend to outperform and protect investors from steep declines. The challenge is determining where we are in the cycle.

Congress analysts look at more than 100 economic indicators each month and pour through stacks of independent investment research to determine if the economic trend is about to shift. In practice, financial markets tend to move in advance of changes in the economy, so the ability to forecast economic adjustments is critical.

MONETARY CYCLE

2. GAUGING THE MONETARY CYCLE

Markets often follow liquidity, and we believe that gauging the stance of global central banks is an essential part of investing portfolios. To estimate central bank policy, Congress analysts follow and analyze the measures that the U.S. Federal Reserve and other central banks around the world are utilizing to manage policy. The Congress team keeps abreast of global economic conditions, the labor market, and inflation gauges, and blends proprietary models and independent research to craft a firm view on global policy settings.

TECHNICAL ANALYSIS

3. TECHNICAL ANALYSIS

Technical analysts believe the behavior of investors offers the best insight into the current state of the markets. Instead of studying fundamental indicators like interest rates, profits, inflation, monetary and fiscal policy, technical analysis examines the movement of security prices.

What is the trend of the market? Are prices over sold or over bought and likely to revert to the mean? Are there divergences between different sectors of the market? What do investor sentiment surveys tell us about investor attitudes? What does the trading volume tell us about investor enthusiasm? These are the questions of technical analysis.

TRADITIONAL VALUATION

4. TRADITIONAL VALUATION

The most famous value investor in the world is Warren Buffett, and his investment strategy is to buy a business when he believes the market has under priced it. When value investors purchase a stock — or in our case, an asset class — at a steep discount to its fair value, they feel they have a built-in margin of safety that protects against market declines. We use many of the tools of traditional valuation analysis in our work, including earning and non-earnings-based ratio analysis, competitive methods of value (like comparing dividend yields to interest rates), and measures of intrinsic value (like Tobin's Q Ratio).

Congress utilizes a proprietary model that scores a variety of valuation techniques to help us find value opportunities.

QUANTITATIVE ANALYSIS

5. QUANTITATIVE ANALYSIS

Congress integrates numerous quantitative models in the decision making process for many of our portfolios. In-house quant models are used to assess implied future portfolio volatility, market valuation, the U.S. business cycle, and more. In addition, we utilize several third-party sources of quantitative analysis.

Quantitative decision making is a necessary balance to qualitative, subjective decision making. We believe that the combination of rules-based quantitative analysis and sound judgement, experience, and informed intuition make a powerful combination for sound portfolio construction.

INDEPENDENT RESEARCH

6. INDEPENDENT RESEARCH

Congress supports our investment team with the best institutional quality research. Independent research is not biased because the firms that sell it do not also sell investment products. Congress analysts follow many different institutional research firms and note when they agree and disagree about market issues. When our reads form a consensus, it becomes a significant part of our decision making process.

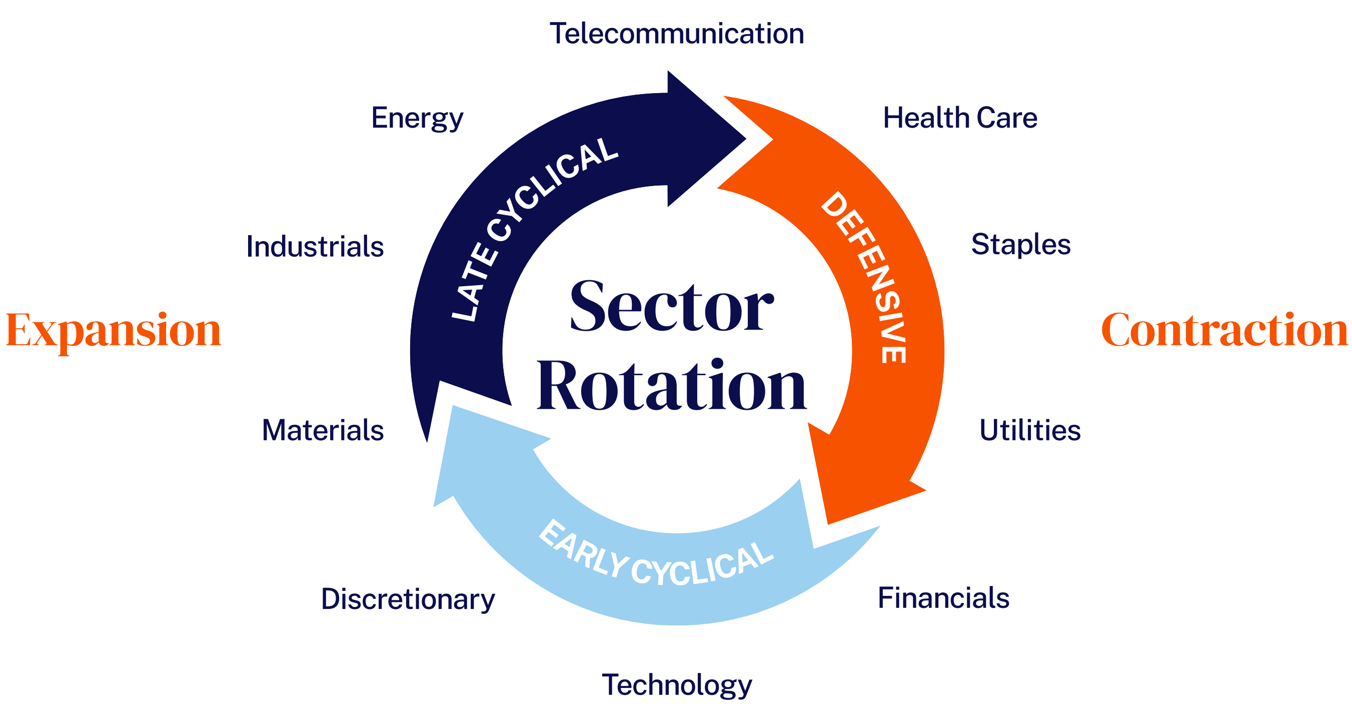
How we seek to earn excess returns

Here at Congress, we're always trying to beat our benchmarks and earn excess returns for our clients. Our first strategy for doing so is to **change the overall asset allocation** of the portfolio with the intention of making significant changes in its volatility. Asset allocation trades would include selling risk assets in favor of less risky asset classes to defend against a bear market. Selling stocks, commodities, or real estate to own bonds or cash are classic changes to asset allocation that have a major impact on portfolio returns. Conversely, buying stocks, commodities, or real estate from cash or bonds in anticipation of a bull market significantly increases our ability to make money during those periods.

Our second strategy for earning excess returns is to **utilize sector rotation** in our portfolio construction. Instead of selling stocks to own bonds, we might sell more volatile sectors of the stock market to own more defensive, less volatile sectors. These trades occur in both the equity and fixed income sectors of the portfolio and are utilized when Congress analysts want to make more subtle changes to the portfolio's risk characteristics.

We're also able to earn excess returns through **security selection.** Congress analysts first decide what kind of security to invest in — an exchange traded fund (ETF) or a mutual fund. They must then determine which ETF or mutual fund to buy. The answer often depends on our analysis of a particular manager or market sector.

We typically use ETFs when we feel we have enough research to make good investment decisions using our in-house resources. On the other hand, we use mutual funds when we need to 'hire' a fund manager to invest in a particular market or specific strategy. Security selection can have an important but subtle impact on overall portfolio returns.



Disclosure

Congress Wealth Management, LLC ("Congress") is a registered investment adviser with the U.S. Securities and Exchange Commission ("SEC") under the Investment Advisers Act of 1940, as amended.

For additional information, please visit our website at congresswealth.com or visit the Investment Adviser Public Disclosure website at www.adviserinfo.sec.gov by searching with Congress' CRD #310873.

Congress acquired certain strategies of Pinnacle Advisory Group, Inc. on April 30, 2021.

The summary of the strategy is based upon the opinions of Congress, and the data available at the time of publication. Information and opinions discussed in this commentary may be superseded, and we do not undertake to update such information.

References to indices, benchmarks or other measures of relative market performance over a specified period of time are provided for your information only and do not imply that the portfolio will achieve similar results. The index composition may not reflect the manner in which a portfolio is constructed. While an adviser seeks to design a portfolio, which reflects appropriate risk and return features, portfolio characteristics may deviate from those of the benchmark.

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